
Construction Period

13.1

Start of Construction

- A. Start of initial construction is the date when contract work commences. It must be diligently pursued without appreciable delay between activities. It includes site clearance and other preparatory site work.
- B. Early start of construction may be authorized in accordance with early start procedures (See Appendix 12-H). Where it occurs:
 - 1. A pre-construction conference is required before the start of initial construction;
 - 2. Construction inspections and change orders must be done in accordance with this chapter;
 - 3. Authorization of any insured advances cannot occur until the endorsed instrument is recorded at initial closing.

13.2

Pre-Construction Conference

Pre-construction conference is required for every project and must precede the initial start of construction, including early start of construction. The HUD representative conducts the pre-construction conference and should hold it at initial endorsement where feasible, since the major participants are present.

- A. Required attendees:
 - 1. Mortgagor's representative;
 - 2. Mortgagor's supervisory Architect;
 - 3. General contractor;

4. Major subcontractor(s);
 5. HUD representative;
 6. HUD mortgage credit analyst; and
 7. Lender's representative.
- B. Supplementary Conditions of the Contract for Construction, Form HUD-2554. Address Davis-Bacon wage rates, Federal labor standards and equal employment provisions, including:
1. Contract obligations of the general contractor and all subcontractors, including:
 - a. Contractor must certify compliance with Davis-Bacon wage rates with each request for advances.
 - b. Davis-Bacon wage rates also apply to a second mortgage backing a governmental equity loan.
 2. Statement of sanctions imposed for not complying with the supplemental conditions.
 3. Requirement that the applicable Davis-Bacon wage decision and the Form HUD-2554 must be made part of the subcontracts for all tiers.
 4. Emphasize the importance of Federal wage payments, prompt certified payroll submissions and proper record keeping. Instruct that a copy of the applicable Davis Bacon wage decision and Form WH-1321, Notice to Employees, must be conspicuously posted on the job site.
 5. Indicate who on the HUD labor relations staff will review for labor standards compliance and refer any further inquiries concerning Davis-Bacon wage and reporting requirements to that staff..
 6. Give copies of the Equal Opportunity poster to the general contractor and the subcontractor(s) to post conspicuously at the job site.
 7. Make available copies of HUD's Contractor's Guide to Davis-Bacon.
- C. Contract Administration
1. Explain general contract administration, including responsibilities of the Lender, mortgagor, mortgagor's Architect, general contractor, and HUD representative.
 2. Explain the procedures for:
 - a. Change orders;
 - b. Requesting construction document clarifications;
 - c. Reporting and correcting non-compliant work;
 - d. Requesting periodic payments and release of escrows;
 - e. Substantial completion of work or portion thereof;

- f. Permissions to occupy including management plans and rent rolls.
- 3. Stress that work changes completed in anticipation of a future change order will be regarded as non-compliant. There will be no insured advances for it or other work dependent on it.
- 4. Periodic advances. Explain:
 - a. Mortgagor's and general contractor's required preparation of requests, including the field approval and subsequent processing;
 - b. Provisions for submitting surveys, title reports, and other documentation in support of construction advances;
 - c. Requirements for contractor's retainage and its release.
- 5. Stored materials. Explain procedures to request payment for materials stored onsite, and components stored offsite where applicable. (See Appendices 13-B and 13-C)
- 6. Offsite work. Explain procedures to request payment for completed offsite work, the required retainage and its release.
- 7. Termination of contract(s). Discuss provisions for terminating the construction contract and/or Architect's contract, and the Lender's responsibilities during the construction stage and in the event of a default.

D. Cost Certification

- 1. Summarize cost certification requirements for the mortgagor and (if applicable) the general contractor, subcontractors, equipment lessors and suppliers, and industrialized housing manufacturers. Where there is a second mortgage backing a Governmental loan, advise that cost certification also applies to the second mortgage.
- 2. Inform all parties that a pre-cost certification conference will be held when construction is 90 percent complete and that complete instructions will be provided at that point.
- 3. Stress that:
 - a. Identities of interest that develop or become known after initial closing must be reported to the Lender and to HUD within 5 working days of having such knowledge;
 - b. HUD must give prior approval for all identity of interest subcontractors and apply penalties where this is not done;
 - c. Self-owned equipment must be certified;
 - d. Paper conduits are prohibited.
- 4. Clarify the 50/75 percent rule. (See Chapter 14.)

13.3**HUD Construction Monitoring****A. Purpose of Inspection.**

1. Inspection means the periodic observations made of construction at the site of a multifamily housing project by a HUD representative (inspector) for the purpose of protecting HUD's interests. Inspections are made to evaluate the contractor's and Architect's performance, to obtain construction in accordance with the contract documents, and to report on conformance with prevailing wages and other contract requirements.
2. The instructions for inspection are the same for projects involving the insurance of advances and those to be insured upon completion, except for those variations specifically stated to be applicable to one or the other.

B. Access. At all times, HUD has the right of access to the property and the right to inspect all work performed and materials furnished to complete the project.**C. HUD construction manager's duties.** The HUD construction manager (CM) or architectural designee is responsible for the proper performance of all functions relating to inspection, as well as the instruction and supervision of all HUD personnel involved. The CM must keep informed of the general progress of the work on all projects during the construction stage and guarantee period and be familiar with the problems involved.

1. Assignment. A member of the HUD staff will be assigned as inspector by the CM prior to the date set for the beginning of project construction. The person inspecting the project may be a Design Representative, a Construction Representative, or any other person or group hired by HUD to do the inspections. In this guidebook that person is referred to as an "inspector." The CM selects the inspector on the basis of competency with due regard to the scope of the project and to the type of construction involved. Several projects being constructed concurrently may be handled by one inspector. Only in very unusual circumstances will an inspector be assigned full time to any one project. Upon assignment, the CM issues to the inspector the following:
 - a. Set No. 3 of the contract drawings and specifications. This set becomes the HUD as-built set by the inspector conforming it to the contractor's "Record Set."
 - b. Copy of the construction contract. The required contract where insured advances are involved are Forms HUD-92442 or 92442A. These forms may or may not be used in insurance upon completion cases, but a construction contract in some form is required and must be furnished to the inspector.
 - (1) Form HUD-92442, Construction Contract-Lump Sum, may be used when there is no identity of interest between the mortgagor and the contractor.
 - (2) Form HUD-92442A, Construction Contract-Cost Plus, may be used in any case, and shall be used when there is an identity of interest between the mortgagor and contractor.

- c. Owner-Architect Agreement, AIA Document B-181, when an Architect is required to administer the construction contract.
 - d. Contractor's and/or mortgagor's cost breakdown - Schedule of Values, Form HUD-2328 when insured advances are involved.
 - e. Drawings and specifications pertaining to offsite improvements.
 - f. Agreements or contracts providing for offsite construction.
2. Field Supervision. The CM shall keep informed of the general quality of inspections and the performance of inspectors by maintaining close contact with their work through job site visits. A regular routine for supervising field operations should be established and followed. Required and suggested methods of field supervision follow.
- a. A minimum of two field review inspections shall be made on each project to evaluate the performance of the HUD inspector. Field review inspections shall be recorded on a HUD Representative's Trip Report, Form HUD-5379. (See Forms Appendix.)
 - b. The HUD inspectors may be accompanied during their rounds. This method is particularly advantageous in training new inspectors.
 - c. Construction should be field reviewed where the use of questionable methods of construction, materials, uncorrected non-compliances, or other problems are reported.
 - d. Projects should be field reviewed at construction stages where problems have occurred in that jurisdiction.
3. Office Review. The CM shall review all Trip Reports, Forms HUD-5379, completed by the HUD inspectors. If the reported conditions indicate the necessity or desirability of field review or other special handling, appropriate action shall be initiated.
- a. Review should not be restricted to the entries on the report. The absence of significant evaluation comments may, under certain circumstances, indicate desirability of field review.
 - b. The CM should be aware of progress, trends, new or uncorrected non-compliances, unusual conditions, etc., in order to be familiar with the work and to initiate any required corrective action immediately.
 - c. The inspector shall be advised of any unsatisfactory action or detail in the report, or any error in its preparation, so that similar mistakes will not occur in the future.
4. Training.
- a. Inspection conferences shall be held when deemed necessary by the CM. The purpose of the conference is to maintain and improve the quality and efficiency of the construction observation function.

- b. Field and office review of inspections will indicate individual training needs and subjects for discussion at inspection conferences.
 - c. It is essential that new inspectors, staff and fee, be trained in the field as well as in the office.
5. Construction progress meetings. Prior to the start of construction the contractor, mortgagor, mortgagor's supervisory Architect and the HUD inspector must be informed by the CM that they are required to attend monthly job meetings. The meetings should be at the job site when monthly request for advances are prepared.
- a. The owner's representative must be a member of the mortgagor entity, usually a general partner. Nonprofit organizations may be represented by a member of the Board of Directors.
 - b. The HUD Inspector must:
 - (1) Comment to the group on the quality of construction and of the Architect's observations and the contractor's supervision.
 - (2) Comment on all known construction defects and deficiencies (non-compliances) and methods of correction.
 - (3) Explain that changes in the work from the contract documents (non-compliances) must be resolved by approved change order requests or the work done in accordance with the contract documents.
 - (4) Inform parties of HUD policy for holdback of construction advances until non-compliances are corrected.
 - (5) Record on Form HUD-5379 the meeting and issues raised. Significant concerns of any party should be presented by memorandum through the CM to the Hub Director.
 - c. Monthly meetings may also be used to resolve equal opportunity and labor disputes. When such disputes are known, the HUD Labor Relations and Equal Employment officers must be invited to attend.
- D. Inspector's Duties. The inspector is the field representative of HUD, not a superintendent for the contractor nor "clerk of the works" for the owner or Architect. The inspector, as HUD's agent, must endeavor in a tactful, helpful and courteous manner to obtain construction that conforms to the drawings, specifications, and sound construction practice within the scope of the contract. The inspector is factual and explicit in all statements in reporting and recording significant construction developments when observed.
- 1. Orientation. Upon assignment to a project, the inspector studies the drawings and specifications and becomes familiar with the conditions at the site. If, during this examination or during construction, any nonconformity with HUD requirements or site conditions not considered in the design are found, they are reported by memorandum through the CM to the Hub Director. The Hub Director will work with the Lender, owner, contractor and other related parties to resolve the noncompliances.

2. Facilities. The contractor must furnish the inspector with enclosed working space that is acceptable to HUD. Adequate, but not elaborate, facilities should be required as soon as actual construction begins at the site. (See the Construction Contract in the Forms Appendix.)
3. Inspections. The inspector shall make at least two job site visits each month. Additional visits may be necessary due to the nature of the project. The frequency of inspection should assure reasonable continuity and recognize the size and character of the project, the speed with which construction is progressing and the quality of work on the project. Visits should be scheduled to observe major construction operations without neglecting lesser operations. Sufficient time must be allotted to each visit to make a complete inspection.
 - a. The major functions during inspection are to: evaluate the construction supervision of the contractor and contract administration of the Architect; report on occupancy, delays, disputes, and changes; report noncompliances with the contract documents observed by the inspector and/or the supervisory Architect; determine that the amounts requested by the contractor and recommended by the Architect for payment are reasonable; conduct employee wage interviews using Form HUD-11; and report on labor and EEO compliance.
 - b. Each inspection shall be recorded on a HUD Representative's Trip Report, Form HUD-5379. (See Forms Appendix.)
4. Start of Construction. The inspector will report the date of initial construction start and the date of the start of permanent construction on Form HUD-5379.
 - a. The date of the initial construction start, used for recording and reporting purposes, is the "start of construction" as used in connection with labor standards and prevailing wage requirements. This is defined as the beginning of initial site clearance and preparation, provided these activities are pursued diligently and are followed, without appreciable delay, by other construction activities.
 - b. The date recorded as the start of permanent construction, used for the purpose of determining the earning of the inspection fee, will correspond to the first day that permanent on-site building elements were put into place, such as footings and/or foundations, pilings, utility lines, etc.
 - c. While excavation is an integral part of foundation work, it does not constitute a start of permanent construction.
5. Unified Report. At the beginning of construction, the inspector should consult with the HUD Design Representative and the CM in regard to the need for inspection of the project by HUD technical specialists. Any differences of opinion between the inspector and the technical specialist in regard to project construction will be resolved by the CM. The inspector submits a unified inspection report to the Architect and the Lender.
6. Shop Drawings and Other Data. During the construction period, the inspector checks whether shop drawings are being submitted by the contractor for approval of the Architect as required by the AIA General Conditions of the Contract. Upon request by the

Architect or the inspector, the contractor will keep copies of tests, certifications and any other data required by the contract documents onsite for review.

7. Offsite Fabricated Construction. If offsite fabricated construction components are involved, the CM will determine if there is a need for inspection at the factory to determine acceptability. If the manufacturing facilities are outside of the jurisdiction of the HUD Office and inspection is essential, the CM submits drawings and specifications which are pertinent, together with a request to the Hub Director to have the inspection made by the HUD Office located near the factory.
8. Distribution. If an Architect is not required for contract administration, then where these instructions require the HUD inspector to submit findings to the Architect, they are submitted to the contractor.
9. Work Stoppage. The HUD inspector will report to the CM on Form HUD-5379 any work stoppage unless such stoppage is due to inclement weather or other similar reasons. If known to the inspector, the reason for the work stoppage should be stated and also when resumption of construction is anticipated.
10. Occupancy. The HUD inspector completes the portion, "FHA Inspection Report," of Form HUD-92485, Permission to Occupy, when submitted. This form is used to request permission to rent or occupy specific living units, commercial or other space. The Form is submitted when the inspector reports safe ingress and egress to the units and/or building, and is evidenced by a certificate of occupancy from the locality. Units and spaces should not be occupied prior to approval by HUD.
 - a. Occupancy prior to the execution of Form HUD-92485 will be reported to the Hub Director by written memorandum.
 - b. The inspector will also include on the Form HUD-5379, the number of units occupied prior to approval, as well as the date occupancy took place.
11. Additional duties. In addition, the inspector:
 - a. Advises the Architect administering the construction contract on HUD requirements.
 - b. Reviews the Architect's job log.
 - c. Reviews copies of the Architect's decisions.
 - d. Reports on project construction progress to the CM on Form HUD-5379.
 - e. Notifies the Architect, and the contractor if an identity of interest exists between the owner and the contractor, as soon as possible if it is determined that there are any essential variations in the cost of the work installed, materials stored and the request for construction advances recommended by the Architect.
 - f. Conducts interviews with an appropriate sampling of the laborers and mechanics engaged. Records interview information. Record of Employee Interview, Form HUD-11, in duplicate, in connection with wage and labor compliance in the construction of the project.
12. Construction record. From the initial construction start through final inspection, the inspector shall be responsible for maintaining a record of construction. The record should also include

minutes of the pre-construction conference as well as reports of required guarantee inspections. The inspector shall initiate a record binder when the CM first assigns the project or may elect to expand the project record binder to include inspection reports. All forms, reports, decisions and documents relevant to construction or inspection reporting shall be recorded in the binder in chronological order. The journal shall be on the left side of the binder and forms and documents on the right. The forms and documents listed below shall be included in the Construction Inspection Record Binder, when applicable.

- a. Drawings and specifications: Sets 1, 2, and 3 referenced in journal though filed elsewhere. (Record the storage location of set 1 and use of 2 and 3.)
- b. Offsite drawings and specifications. (Referenced in journal.)
- c. Construction Contract, Form HUD-92442 or 92442A.
- d. Owner-Architect Agreement.
- e. Progress schedule.
- f. Contractor's and/or Mortgagor's Cost Breakdown, Form HUD-2328.
- g. HUD Representative's Trip Reports, Form HUD-5379.
- h. Contractor's Requisition, Form HUD-92448.
- i. Change Orders Form HUD-92437, AIA G710, and Architect's supplemental instruction or equivalent.
- j. Letters, memoranda, notes, and worksheets.
- k. Journal of Architectural Actions (if separate binder).
- l. Surveyor's Report, Form HUD-92457 (final and others, if requested).
- m. Permission(s) to Occupy, Form HUD-92485.
- n. Record of established escrow including amounts escrowed, a complete list of unfinished construction items, record of call back inspections and recommendations for monies to be released.

13. Projects insured on completion. The inspector reports the percentage of completion of the project on Form HUD-5379 at the end of each month. This percentage is an approximation for general information and is not used for disbursement.

14. Offsite inspection. The inspector checks all offsite construction for conformity with the terms of the contract and reports progress of work by percentages on Form HUD-5379. Completion is reported on Form HUD-92464.

E. Reporting and dealing with serious construction problems. HUD Offices must identify and report to the Hub Director and the HUD Office of Quality Assurance all insured multifamily projects under construction or in the guarantee period which have serious construction defects or other serious construction related problems.

NOTE: This information will be used to reply to inquiries, as an "early warning system" to troubled projects, and to determine if assistance to the HUD Office is necessary.

1. The inspector must identify all construction problems that may delay completion or lead to foreclosure or assignment of the mortgage to HUD on Form HUD-5379, HUD Representative's Trip Report.
2. The CM must prepare a referral memorandum to the Hub Director when:
 - a. Work stops for 20 calendar days.
 - b. There are slow or nonpayments to the general contractor and/or subcontractors.
 - c. Contractor abandons the job.
 - d. Contractor, owner or Architect changes during construction.
 - e. Correction of any construction deficiency is not started within 30 days of the first notification to the contractor.
 - f. Contractor can't or won't correct any construction defect or latent defect.
3. The referral memorandum must include full details of the construction related problem. Include at least:
 - a. A copy of Form HUD-5379, which identifies the problem.
 - b. The inspector's opinion of the cause and recommendation for correction.
 - c. A report of action by the CM and/or other HUD Office staff.
 - d. A report of actions by the owner, Architect, contractor, mortgagee and bonding company (when appropriate).
 - e. A plan of action by the HUD Office if the mortgage is assigned to HUD during construction, or foreclosure is initiated by the Lender.
4. Only the initial report is required unless the Hub Director requests further action or follow-up by the HUD Office.
5. For complete instructions on handling problems before closing, see Appendix 13-D.

13.4**Architect's Duties in Administering Construction Contract**

The Architect shall:

- A. Provide services in accordance with the Owner-Architect Agreement.
- B. Have no identity of interest with the owner or contractor. An identity of interest is defined in the HUD Amendment to the Construction Contract. (See Forms Appendix.)
- C. Ensure that construction is carried out in accord with the contract documents.
 - 1. Restrict materials, products and equipment to those specified.
 - 2. Restrict all deviations to those substantially consistent with the original design concept including form, color, and texture.
 - 3. When arriving at the net amount due on every requisition, compare the cost of the work and materials with the cost to complete the project. Current and previous payment must relate to the total cost for completion.
 - 4. Restrict substitution of items of a different design or size from those specified to those that are equivalent in utility (i.e., durability, quality, and ease of maintenance).
 - 5. Restrict substitution of any material differing in composition or appearance from the one specified to one which is equivalent in its attributes (i.e., character, quality, durability and ease of maintenance).
 - 6. Keep a log on the site that is readily available to the owner and HUD representatives.
- D. Architect's supplemental instructions. The architect administering the construction contract may issue field orders using AIA Document G710, Architect's Supplemental Instructions, or a similar form.
 - 1. The architect must send a copy of each supplemental instruction to HUD, though prior approval by the Lender and HUD is not required.
 - 2. Supplemental instructions must not involve a change in contract sum or contract time.
 - 3. Uses of supplemental instructions.
 - a. Directive to contractor to bring construction into compliance with the contract documents.
 - b. Interpretation or clarification of the contract drawings and specifications.
 - c. Order minor changes in the work, not involving cost.
 - d. Accept specified equivalent.
 - e. Record other "field orders" that are not construction changes.

- E. The Architect administering the construction contract is responsible for reporting in writing the results of periodic visits to the construction site. The Architect's log should provide information regarding assessment of the progress of the work and a record of the actions taken to insure that the work is being accomplished in the best interests of all the parties.
1. The American Institute of Architects (AIA) Document G711, Architect's Field Report, may be used for the log.
 2. A log of each visit should show as a minimum the following:
 - a. Date of inspection.
 - b. HUD project identification and location.
 - c. Time, weather, and temperature range.
 - d. Estimated percent of completion.
 - e. Work in progress and conformance with the contractor's progress schedule.
 - f. Persons present at work.
 - g. Observations and items to verify.
 - h. Information or action required.
 - i. Firm name and signature.

13.5**Architect's Adequacy**

The provision for the Architect's administration of the construction contract is covered by the Owner-Architect Agreement and by the General Conditions of the Contract for Construction, AIA Document A201. It is the responsibility of the HUD inspector to determine the adequacy of the Architect's administration. The determination of adequacy will not be based on the number of visits or the length of time spent by the Architect on the job but by construction that complies with the contract documents as a result of the Architect's observation.

- A. Deficient administration. If the Architect does not report all observed noncompliances with contract documents and unacceptable performances by the contractor and exploit all avenues to obtain compliance with the contract, then the Architect's administration of the construction contract will be considered deficient. The Architect will not be responsible for actual construction, construction means, methods, techniques or other related responsibilities of the contractor. However, on the basis of on-site observation as the owner's representative, the Architect must keep the Lender, owner and HUD informed of the progress of the work and endeavor to guard the owner and HUD against defects and deficiencies in the construction.
- B. Reasons for termination of services. Inadequate performance, undue delay, misrepresentation or failure to act on the part of the Architect or the Architect's associates and employees shall

be reason for the termination of the Architect's services on the project and may adversely affect the firm's acceptability on future projects.

- C. HUD office actions. The HUD inspector shall bring to the attention of the Architect specific areas in which services are considered deficient. Sufficient time and appropriate assistance shall be given to obtain necessary compliance.
 - 1. When the Architect's performance is first observed as deficient, in addition to the HUD Representative's Trip Report, Form HUD-5379, the inspector shall also prepare a written memorandum to the CM of the deficiency advising of any planned actions or assistance. The memorandum should recommend that future requests for Architectural inspection fees be disallowed until performance improves to an acceptable level.
 - 2. An immediate follow-up by the CM is always required. Conferences with the inspector and the Architect should be arranged and a target date established for the Architect to obtain compliance. The CM shall inform the Hub Director of current problems and of established target dates for corrections. Deficiencies related to misrepresentation, undisclosed identity of interest and known illegal kick-backs should be immediately referred to the HUD Office Counsel with a copy to the Hub Director. All actions by the HUD Office shall be clearly documented.
- D. Request for contract termination. When compliance with the contract cannot be obtained within thirty (30) days, the Hub Director shall request termination of the Architect's contract in accordance with the provisions of the Owner-Architect Agreement. Upon termination, the Architect shall be entitled to only the prescribed portion of the fee determined by the percentage to which construction was completed on the date that the Architect was removed from the project. The Hub Director has full authority to secure acceptable performance.
- E. Contract termination. The owner will hire an independent Architect who is acceptable to all parties to continue the administration of the project construction documents. The HUD inspector does not assume the Architect's responsibility.

13.6

Completion Inspections

- A. Substantial completion. The Architect dates and signs the certification on Form HUD-92485, Permission to Occupy, that part or all the work is sufficiently complete, in accordance with the contract documents, and may be occupied for the use intended.
 - 1. The contractor submits a punch list of items to be completed or corrected to the Architect when the work is ready for occupancy. (See Article 9.8, AIA Document A201.)
 - 2. The Architect inspects, checks the punch list and modifies if necessary, and determines when the work is substantially complete. (Dwelling units containing punch list items will not be accepted for occupancy. However, punch list items in interior common areas and on the exterior do not preclude occupancy.)

3. The HUD inspector verifies on Form HUD-92485 the date when the work is suitable for occupancy.
- B. Final completion inspection. The Architect and inspector make the final inspection upon written request of the contractor. (Inspection may be made individually.)
1. The Architect determines that all punch list items have been completed unless they are beyond the control of the contractor. (Items of delayed completion.)
 2. The inspector prepares the final inspection report on Form HUD-5379. The inspector:
 - a. Reports onsite construction complete though there may be items of delayed completion.
 - b. Lists and describes any items of delayed completion.
 - c. Lists any offsite work and reports percentage of completion for each.
 3. The HUD Construction Manager (CM) checks the final inspection report.
 - a. If unacceptable, requires reinspection. (Report is not considered final.)
 - b. If acceptable, endorses the report as follows:
 - (1) "Construction acceptably completed." (If there are items of delayed completion, add, "subject to escrow of funds to assure completion of listed items of delayed completion.")
 - (2) "All offsite sewer, water, electrical and gas facilities are complete, connected and operable, and safe, adequate, all-weather ingress and egress provided." (If offsite item incomplete, adds, "except as stated at the time of inspection.")
 - (3) CM dates and signs the endorsement.
 - c. CM prepares memorandum for the signature of the Hub Director transmitting the final inspection report.
 - (1) States date of final completion (date of final inspection).
 - (2) Lists incomplete offsite work.
 - (3) Lists items of delayed completion and estimate of cost of completion for each item.
- NOTE: Escrow must not be less than 150 percent of the estimate to complete and must not exceed 2 percent of the mortgage. Work must be completed within 12 months of the date of the final HUD inspector's trip report.
- C. Guarantee inspections. A minimum of two inspections are made of all work to discover and require correction of latent defects (defective or nonconforming work not observed during construction) within 1 year of the date of final completion.
1. The HUD CM schedules guarantee inspections.

- a. First must be within 9 months of final completion and should provide for inspection of the entire project.
 - b. Others may be necessary to assure inspection of seasonal items such as heating and landscaping.
 - c. The last must be not later than the 10th day of the 12th month to check previously reported defects and correction, and discover any additional defects.
2. The inspector reports each guarantee inspection on Form HUD-5379.
 - a. If work is acceptable, state, "All observable work acceptable at the time of this inspection."
 - b. If unacceptable, list latent defects.
 - (1) Describe each item.
 - (2) Recommend method of correction.
 - (3) Estimate current cost of correction.
 - c. Check any item of delayed completion and list completed and uncompleted items under a separate heading.
 - d. Note any improper maintenance or casualty damage under a separate heading.

13.7**Insurance of Advances and Related Matters****A. General.**

Insurance of advances is the process of releasing FHA insured mortgage funds and other funds necessary for the construction, acquisition, and/or refinancing of the project. The following general criteria apply to advancing such funds.

1. All escrowed funds for on-site improvements (with the possible exception of grant/loan proceeds furnished by a government agency or instrumentality) must be disbursed before mortgage proceeds.
2. The amount of construction funds approved and advanced for insurance must be consistent with construction progress reported by the HUD Field Representative.
3. Other mortgageable items must be supported with proper bills and/or receipts before funds can be approved and advanced for insurance.
4. The amount advanced for construction items must be adjusted for a 10 percent holdback.
5. The final amount approved for insurance must be supported by certified costs recognized in the cost certification review.
6. The Application for Insurance of Advance of Mortgage Proceeds is done on Form HUD-92403. It is initiated by the mortgagor. The initial and final advances are submitted by the

Lender to HUD for review and approval. Interim advances are approved by the Lender, based upon HUD inspector approval of the construction amount.

7. Supporting materials to Form HUD-92403 include supporting bills/receipts and Form HUD-92448, Contractor's Requisition, if requesting construction funds.

B. Lender's role in processing HUD-92403.

1. Completes application indicating:
 - a. Amount requested by mortgagor;
 - b. Approximate disbursement date;
 - c. Amount to be advanced from mortgage proceeds;
 - d. Amount disbursed from mortgagor's front money escrow, if any; and
 - e. Total loan proceeds disbursed including current request.
2. Submits initial and final application to HUD for review and approval.
3. Processes and approves interim advances.
4. Ensures clear title before advancing the approved disbursement.
5. Notifies HUD in writing when clear title does not exist.

C. Stages of Advances.

In cases involving insurance of advances, HUD and the Lender's processing of the advance is divided into the following stages:

1. Initial advance. Refers to the first application and coincides with the initial endorsement of the credit instrument. The initial advance will be reviewed and executed by the HUD mortgage credit analyst. The Lender should submit Form HUD-92403, Application for Insurance of Advance of Mortgage Proceeds, with supporting documentation for HUD approval.
2. Interim advances. Refers to subsequent applications up to completion of the project. Interim advances will be processed and approved by the Lender.
3. Next to final advance. Refers to the application for the release of the final 5% of the construction holdback upon receipt of contractor's certification, and consent from mortgagor, and surety, if any.

Note: This only applies to non-identity of interest contractors or where the contractor's identity of interest is a project ownership of less than 5 percent.

4. Final advance. Refers to the application for any remaining balance of mortgage proceeds at final endorsement. This advance takes into consideration funds necessary to set up the escrows for "Items of Delayed Completion" and "To Be Paid In Cash Items". The final advance will be processed by HUD. In addition to the Form HUD-92403, the Lender must submit a copy of Form HUD-92451 Financial Record of Mortgage Loan Transaction, which reflects releases to the various payees during the construction period.

- D. Instructions for Approval of Initial/Interim Advances. These instructions can be found in Appendix 13A.
- E. Contractor's Monthly Requisition and Related Matters. See Appendix 13B for instructions on completing Contractor's Requisition, Form HUD-92448, and related matters.
- F. Next to Final Advance. Requested when construction is acceptably complete, even though there may be items of delayed completion.
1. It may provide for the release of the contractor's holdback provided the conditions in section 13.15.D have been met. The amount approved for release is based on the cost certification review and HUD-approved amount, and considers items of delayed completion.
 2. The balance of the offsite escrow may be released provided:
 - a. The offsite sewer, water, electrical and gas facilities are completely installed and connected; and safe and adequate all weather facilities for ingress and egress are provided.
 - b. All other required offsite construction, if any, is completed.
 - c. Otherwise, completion is to be assured by a cash deposit in an amount equal to 150 percent of the HUD estimate of the cost of such offsite construction.
- G. Final Advance. The Application for Insurance of the Final Advance requests any remaining balance of mortgage proceeds. Ensure that:
1. The mortgagor's cost certification has been approved and the maximum insurable mortgage amount determined using Form HUD-92580, Maximum Insurable Mortgage. See Chapter 14.
 2. Form HUD-92403 is accompanied by a completed Form HUD-92448, with required Contractor's Prevailing Wage Certificate, if the contractor's holdback has not been previously disbursed. Refer to section 13.15.D for instructions on releasing the contractor's holdback.
 3. The sum to be approved for advance is the balance of the mortgage proceeds, based on the maximum insurable mortgage on Form HUD-92580. Refer to Chapter 7 for instructions relative to advance amortization adjustment, if any.
 4. Set up the escrow under the provisions of Form HUD-2456, Escrow Deposit Agreement, for items of delayed completion.
 5. Form HUD-92023, Request for Final Endorsement of Credit Instrument, or FHA-2453, Commitment to Insure Upon Completion, have been submitted and reviewed.
 6. Set up the escrow for the mortgagor's unpaid construction costs under the provisions of Form HUD-92476.1, Escrow Agreement for Unpaid Construction Costs, Repairs or Needs Assessment Repairs. Refer to Chapter 14.
- H. Keeping the mortgage in balance.

Overruns in soft cost such as interest, taxes, MIP, and insurance which results due to delays before completion of the project and which are the fault of the general contractor, i.e., poor performances, are funded from the liquidated/actual damages clause in the construction contract. This clause is not intended to penalize the contractor, but to provide a source of funds for the increased soft cost. When the interest allocation is near exhaustion, HUD should be notified immediately. The lender should ask the Architect and the HUD inspector to estimate an expected completion date, and follow the following procedure:

1. When the interest allocation is near exhaustion, ask the Architect and the HUD inspector to estimate an expected completion date.
 - a. Compute the minimum liquidated damages for the period between the completion date specified in the construction contract, as adjusted by approved change orders, and the assumed completion date.
 - b. When the interest allocation has been exhausted, Developer's fee if applicable, or the working capital escrow should be used to keep interest current.
 - c. Transfer the computed liquidated damages amount from column I, Construction, to Column G, Carrying Charges and Financing, on Form HUD-92451.
 - (1) Allocate full amount to interest, initially.
 - (2) Funds may be used for MIP, taxes, or insurance payments, if requested, after the funds for these line items and nonprofit Developer's fee, if applicable, and working capital escrow are exhausted. However, funds transferred from the construction account may be used to cover only the cost of these items attributable to the period in Paragraph 1 above, specified in the construction contract and the assumed completion date.
2. Notify the mortgagor, contractor, HUD and surety, if any, by certified mail of the amount and the reason for the transfer.
3. Require written acknowledgment from HUD and surety, if any, before transferring funds.
4. The amount of transferred funds must be reflected on subsequent Forms HUD-92448 as a decrease to item 7, Sum of Cost Breakdown Items Plus Inventories of Materials.
5. After review of the cost certification documents, if the full amount of transferred funds was not needed to cover the cost of interest, MIP, taxes, and insurance attributable to the period identified, the balance will be transferred back to the construction account.
6. In processing Form HUD-92448, before releasing the general contractor's holdback, make adjustment for the lesser of actual or liquidated damages determined in the cost certification review.
7. This procedure only should be invoked only if in consultation with the Hub Director, it is determined that the problems causing the delay will be remedied within the near future.

- A. General instructions. Construction contract changes (change orders) to the scope of contract work, contract price or contract time must be requested by the mortgagor through the Lender on Form HUD-92437, Request For Construction Changes. Forms must be signed by the mortgagor's Architect, the mortgagor, the general contractor, and the Lender. HUD approves the change order.
1. HUD reviews and approval. Each HUD discipline as appropriate, including Architecture, Cost, Appraisal, Mortgage Credit, and the HUD inspector must review and make a recommendation to the HUD construction manager.
 2. Approve change orders only when they are necessary, are a betterment, or an equivalent. The following information should appear on the face:
 - a. Classification (necessity, etc.);
 - b. Qualification for payment from the contingency reserve in rehabilitation projects and from the Developer's fee for nonprofit mortgagors;
 - c. Whether change order results from error, omission, or negligence on the part of the Architect, contractor, or mortgagor.
 3. Do not approve any change orders submitted after the final HUD Representative's Trip Report, except where:
 - a. The change order pertains to "Items of Delayed Completion," or
 - b. Written approval is given by Hub Director.
 4. Surety Approval must be secured in writing before approving any change or aggregate of changes that increase the contract price 10 percent or more. There is no consent requirement where the project's assurance of completion is by a cash escrow or letter of credit.
- B. Policy.
1. Changes must be accurately reported and accounted for pursuant to U.S. Criminal Code, Section 1010, Title 18, U.S.C.
 2. Procedures for changes outlined here are not to be used to alter the intent of contract documents or to lower the quality or value of a project.
 3. HUD does not initiate any change but may require them as a condition of approval in connection with a change proposed by the Architect, mortgagor, or contractor.
 4. All changes must be approved in writing by the Lender and HUD before they are made.
 5. Any change that is made without formal approval, even though tentatively agreed to as technically acceptable, must be recorded by the HUD inspector as a noncompliance. This stands until the Form HUD-92437, Request for Construction Changes - Project Mortgages, is approved, and also affects payment of advances.
- C. Change order classification.
1. Necessary changes (HUD Representative should document the reasons) are those that arise from:
 - a. Latent conditions that differ from conditions defined by the construction documents;

- b. Changes in the applicable codes, ordinances, etc. after:
 - (1) Initial closing for insured advances;
 - (2) Firm Commitment for insurance upon completion;
 - c. The Architect's errors or omissions;
 - d. Damage to completed construction.
2. Betterment changes are those that are economically justified. They must either:
- a. Increase net income;
 - b. Reduce long-term project maintenance and/or operating expenses;
 - c. Otherwise enhance the mortgage security.
3. Equivalent changes are those proposed because:
- a. Specified item is not readily available and the substitution provides equivalent or better utility, or
 - b. Proposed substitution reduces the contract price but provides equivalent or better utility and performance.
- D. Additive change orders. Do not give any explicit or implied assurance that an increase in the insured mortgage amount will be granted when approving construction changes.
1. Require the mortgagor, except for "necessary" change orders on substantial rehabilitation projects, to escrow funding with the Lender for any additive change order where HUD first estimates that the aggregated change orders equal or exceed a \$5,000 increase in the construction contract price, and for all subsequent additive change orders. Nonprofit mortgagors may use the Developer's fee to fund additive change orders.
- a. Excess mortgage proceeds, if available, may be used to fund the escrow for "necessary" and "betterment" change orders. However, any excess mortgage proceeds used to fund the escrow for contractor estimated costs in excess of HUD estimated costs, or HUD estimated costs in excess of contractor estimated costs, may not be disbursed until final closing.
 - b. Permit Lender to accept a third party letter of credit instead of a cash deposit, subject to the Lender agreeing to provide the cash equivalent, where the letter of credit is not immediately met.
 - c. Recognize the cost of third party paid change orders at cost certification, where there are available mortgage savings.
2. On substantial rehabilitation projects, approve payment from the established contingency reserve in an amount not to exceed the HUD cost estimate for "necessary" additive change orders. "Betterment" change orders are not eligible for payment from the contingency reserve.
- a. Require an escrow for any amount that the contractor's cost estimate exceeds the HUD estimate.

- b. Authorize use of excess mortgage proceeds, if available, to satisfy the escrow requirement, subject to the disbursement limitations in paragraph 13.8.D.1.a above.
 - 3. Approve the following forms for mortgagor's application of funds for completed additive change orders:
 - a. Form HUD-92464, Request for Approval of Advance of Escrow Funds, where an escrow is used.
 - b. Form HUD-92403, Application for Insurance of Advance of Mortgage Proceeds, where a rehabilitation project's contingency funds or nonprofit's Developer's fee or excess mortgage proceeds are used.
- E. Deductive change orders. Where the HUD estimated decrease in contract price for any aggregation of change orders:
 - 1. Remains less than 2-1/2 percent of the contract price, reduce the Contractor's "Final" Requisition, Form HUD-92448, by the appropriate amount.
 - 2. Equals or exceeds 2-1/2 percent of the contract price and for all subsequent deductive change orders regardless of the amount:
 - a. Reflect the decrease in the Contractor's Requisition, Form HUD-92448, Item (8).
 - b. Reduce the original mortgage amount at cost certification, where required.
- F. Changes that adversely affect income are a basis for change order rejection, except where it is a necessary change order and the situation is unavoidable.
- G. Extension of contract time.
 - 1. Approve an extension only where:
 - a. The delay was beyond the contractor's control (e.g. strikes, differing site conditions, bad weather exceeding the average for the season, etc.) and is documented or associated with an approved change order,
 - b. The extension request was submitted within the limit provided by the contract and the general conditions for delays beyond the contractor's control, and submitted concurrently with any requested changes in the work, and
 - c. The request is accompanied by a surety's written consent. There is no consent requirement where the project's assurance of completion is by a cash escrow or letter of credit.
 - 2. Require funding for the increased cost for overhead, interest, taxes, insurance, MIP, and contractor's general requirements by use of a cash escrow, or excess mortgage proceeds, or nonprofit's Developer's fee, if applicable, or from contingency reserve.
 - 3. HUD enforces liquidated damages in accordance with the contract.
 - 4. Required documentation. Within 21 days of the date a construction delay occurs, the contractor must document it with the Architect and include:
 - a. Date of occurrence and number of calendar days it covered.

- b. Effect on construction progress.
 - c. Cause of the delay. If the cause is of a continuing nature, submit the extension request when the cause ceases, but still record the initial date of occurrence and its effects on construction.
 - d. Extension request must also include written consent of the surety and conform to AIA Document A201, Article 8.3.
- H. Changes to items of delayed completion. These are the only construction contract changes that the HUD Office can approve after project completion. All others require the Hub Director's consent.
- I. Emergency changes.
 - 1. The only time a change can be made without prior written approval of the mortgagee and HUD is in emergencies that:
 - a. Endanger life or property or
 - b. Halt construction.
 - 2. However, even then, the Architect must notify the Lender and HUD and, as soon as possible, submit a Form HUD-92437.
- J. Insurance upon completion: Construction Contract Changes, Form HUD-92437, are processed in the same way as Insurance of Advance cases, except as modified:
 - 1. An escrow is not required for additive change orders. The mortgagor:
 - a. Must be able to provide the additional funds required and
 - b. Must not have any outstanding obligation in connection with construction other than the insured mortgage at the time the mortgage is presented to HUD for insurance upon completion.
 - 2. Surety approval is not required for the approval of additive change orders regardless of the percentage of contract increase.
- K. Changes to offsite construction must be requested by letter or other acceptable format. Form HUD-92437 may be used as a general guide, but the actual form must not be used.
- L. Other changes. These changes necessitated by error, omission, or negligence of Architect, owner, or contractor must be so recorded by HUD architectural staff or inspector, on Form HUD-92437.
 - 1. Record the reason for the determination.
 - 2. Indicate that the cost effect must not be included in the mortgage amount.

13.9**Change Orders – HUD Inspector Instructions**

A. General procedure. (For specific situations, see the appropriate subject heading.)

NOTE: For projects involving insurance upon completion, references here to "contract requirements" or "contract documents" include the conditions and provisions of the commitment if there is no construction contract.

1. Contemplated changes are first discussed among the Architect, contractor, owner, and HUD inspector.
2. HUD inspector makes a preliminary determination of technical acceptability before the change is submitted for approval of the Lender and the HUD Office. (This neither commits HUD to the change, nor relieves the Architect or the contractor of having to submit the Form described below.)
3. All onsite changes to construction documents and requests for time extensions must be submitted for approval on Form HUD-92437, Request for Construction Changes - Project Mortgages.
 - a. Required attachments for physical changes are:
 - (1) Appropriate modifications to the contract drawings and specifications;
 - (2) Architect's statement that the change:
 - (a) Conforms to the original intent of the contract drawings and specifications; or
 - (b) Is necessary to overcome an impediment to construction, or is an addition desired by the owner.
 - (3) Backup documentation for amount(s) requested consisting of itemized quantities and costs.
 - b. The form must be signed by:
 - (1) mortgagor,
 - (2) contractor,
 - (3) Architect (if an Owner-Architect Agreement is in effect), and
 - (4) authorized official for the Lender.
4. All offsite changes must be:
 - a. Requested in a letter or other format acceptable to the field office, but not Form HUD-92437.
 - b. Documented and processed the same as on-site changes.
5. The HUD office must promptly review all requests submitted. (Delays could affect construction or contractor requisitions.)

- a. Processing should normally take no more than 5 workdays and is directed by the Construction Manager.
- b. All construction change requests must be reviewed, signed, and dated by the Construction Manager.
6. Voiding changes. If an approved change is not made, it must be nullified by a Form HUD-92437 restoring the drawings and specifications to the status prior to the change request or to a status acceptable to HUD.
7. Unapproved changes. When there are unapproved changes in the construction, the HUD inspector must modify the amount of the contractor's requisition to cover:
 - a. The non-compliance (any change that has not formally been approved on Form HUD-92437) and
 - b. Construction removal that may be required if the unapproved change does not receive approval.

13.10**Change Orders – HUD Architectural and Cost Instructions**

A. Architectural. Review all requested changes for technical acceptability.

B. Cost.

1. Construction changes:
 - a. The HUD cost estimator will produce a cost estimate for each construction change request submitted by the mortgagor. Apply current data to accepted or amended change order quantities. Include amounts for general requirements and builder's overhead and profit using the percentage of each from Section G of Form HUD-92264 at Firm review.
 - b. Compare estimate with mortgagor's estimate. If reasonable, use mortgagor's figure, otherwise use HUD estimate.
 - c. Complete cost entries on Form HUD-92437 and forward completed form to HUD mortgage credit examiner and/or the appraiser, if applicable.
2. Approved time extensions:
 - a. Calculate additional general requirements cost due to extension of time.
 - (1) Divide cost of general requirements from contractor's approved Form HUD-2328 by the number of months estimated for construction from Section G of Form HUD-92264 at Firm commitment. Sixty-five percent of this amount is the estimate per month of additional general requirements.
 - (2) Use one quarter of the monthly estimate per week.
 - (3) There is no cost effect for extensions of time for less than one week.
 - b. Complete cost entries on Form HUD-92437 and forward completed form to HUD appraiser and mortgage credit examiner.

13.11**Change Orders – Appraisal and Mortgage Credit Instructions****A. Appraisal.**

1. The HUD appraisal staff must review all requested changes that may effect marketability, value, income, or maintenance or operating cost; and to identify and explain any estimated increase or decrease in net project income on the reverse of Form HUD-92437.
2. The appraiser must forward a Trial Form HUD-92264 and Trial Form HUD-92264-A reflecting the new data for Mortgage Credit redetermination of the maximum insurable mortgage.

B. Mortgage credit.**1. Processing.**

- a. If the mortgagor's or contractor's estimate for the change order exceeds HUD's estimate, the difference must be escrowed with the Lender. Excess mortgage proceeds, if available, may be used to satisfy this requirement. Conversely, that portion of HUD's estimate which exceeds the mortgagor's or contractor's estimate must be restricted and held until final endorsement to ensure funds to complete the project.
- b. Process the cost and appraisal findings and show the cumulative effect on cost of all approved change items.
- c. Use paragraphs 13.8.D and 13.8.E for additive and deductive change orders.
- d. Recalculate the maximum insurable mortgage when any approved construction change or changes adversely affect net income, e.g., a change that causes an increase in operating costs.
 - (1) Appraisal completes a Trial Form HUD-92264 with an updated income and expense analysis.
 - (2) Re-determine the maximum insurable mortgage.
 - (3) If the re-determined mortgage is lower than the original mortgage amount, as a condition of approval of the change order, indicate in item 3b of Form HUD-92437 that subsequent Contractor's Requisitions, Form HUD-92448, must be reduced by the greater of:
 - (a) The difference in mortgage amounts;
 - (b) The net increase in costs resulting from acceptable construction changes.
- e. Extensions of time.
 - (1) Architectural and cost technicians are responsible for determining whether the delay was beyond the contractor's control and, if so, the length of the approved time extension.

- (2) Calculate the cost increase due to the extension:
 - (a) Compute daily rate for interest, taxes and insurance by using estimates in Section G of Form HUD-92264 and multiply these rates by the approved time extension.
 - (b) An additional year of MIP will be required if the approved time extension, when added to the estimated construction term plus the 2 months included in Section G of Form HUD-92264 plus previously approved time extensions, will require an additional MIP payment during the construction period.
 - (c) Add the additional general requirements, if any, noted by the Cost branch on the change order request.

NOTE: Only Item (c) above amends the construction contract price on Form HUD-92437.

- (3) Determine the source of funds for any increase due to the extension, i.e., cash, excess mortgage proceeds or nonprofit's Developer's fee, or contingency reserve funds.
 - (4) Requests for release of excess mortgage proceeds or contingency reserve funds set aside to fund time extensions are submitted on Form HUD-92403.
 - (5) Releases from a cash deposit are made using Form HUD-92464.
 - (6) These funds may be released only after the account for the soft cost item(s) being requested has been exhausted on Form HUD-92451, Financial Record of Mortgage Loan Transaction.
2. Requests for disbursement of contingency reserve funds and nonprofit's Developer's fee for completed change order items are made on Form HUD-92403. All requests:
 - a. Must be accompanied by a certification by the mortgagor's supervisory Architect and the HUD Inspector that all the work covered by the change order has been acceptably completed in accordance with contract documents.
 - b. Must include the mortgagor/borrower's certification relative to payment to the contractor contained on Form HUD-92464, Request for Approval of Advance of Escrow Funds.
 - c. Must include the criminal certification contained on Form HUD-92464 for certifications made in paragraphs a and b above.
 - d. Are subject to a 10 percent holdback.
 3. Change orders funded from excess mortgage proceeds. Excess mortgage proceeds may be used to fund either necessary or betterment change orders.
 - a. These funds may be used to fund HUD's estimate of increased costs as well as any portion of the contractor's estimate which exceeds the HUD estimate. The

portion which exceeds HUD's estimate must be restricted until final endorsement.

- b. Funds are released in the same manner as contingency reserve funds.
4. Releasing Cash Deposit. The mortgagor submits through the Lender Form HUD-92464 when construction covered by a cash deposit is complete and acceptable to HUD.
- a. The mortgagor's supervisory Architect and the HUD inspector must certify on Form HUD-92464 that all work and materials covered by the change order are satisfactory and consistent with contract drawings.
 - b. If construction costs were paid in full with other than the cash escrow or excess mortgage proceeds before submitting the disbursement request to HUD for approval, the mortgagor must submit a receipt of payment signed by the general contractor.
 - c. If construction costs will be paid after HUD's approval for the release of the funds deposited for the construction change, before the next Form HUD-92403 is submitted, the mortgagor must submit a receipt of payment signed by the general contractor.
5. Change Order Summary Sheet_showing cumulative cost of all executed change orders should contain, at least:
- a. The date the change order was signed by the mortgagor;
 - b. The date HUD received the change order;
 - c. The date the Mortgage Credit branch processed the change order;
 - d. The mortgagor's or contractor's estimate of cost for the change order;
 - e. HUD's estimate of cost for the change order;
 - f. The amount of change orders to be funded from contingency reserve, nonprofit's Developer's fee, or excess mortgage proceeds;
 - g. The required cash escrow deposit, if any;
 - h. The HUD percentage of cost increase or decrease.

13.12**Labor and Fair Housing and Equal Opportunity (FHEO)****A. Wages**

1. Payrolls. Contractor payrolls are submitted directly to the HUD Labor Relations staff a minimum of once a month.
2. On-site interviews. The HUD Construction Manager forwards all original copies of Form HUD-11, Record of Employee Interview, which are submitted by the HUD inspector, to the HUD Labor Relations Staff.

B. Labor violations. Advise the Labor Relations Staff of continuing minor infractions that cannot be resolved or of any identified or suspected major violations.**C. FHEO violations.** Advise the HUD Director of FHEO of continuing minor violations that cannot be resolved or of any identified or suspected major violations.**13.13****Surveys**

Surveys must be by a licensed surveyor and show the exact location of on-site improvements, including utility lines and easements.

A. The contractor must give the owner and HUD surveys:

1. At any time the owner or HUD requires, and
2. When construction is complete.

B. The inspector, when uncertain of the location of construction or stored materials in relation to property lines or easements, may ask the Architect to require a survey with the next contractor's requisition.**C. If encroachments are found, the inspector must notify the HUD Construction Manager by memorandum explaining the conditions. (Encroachments may jeopardize the entire property as security for an insured mortgage.)**

13.14**Permission to Occupy**

Permission to Occupy, Form HUD-92485, must be executed by HUD before the mortgagor permits occupancy of any dwelling unit, care facility unit, or other project service facility.

- A. Physical completion. The Work or portion thereof for which a Permission to Occupy is approved must be sufficiently completed in accordance with the contract documents so the mortgagor can occupy or utilize the identified portion of the work for its intended use.
 - 1. Support facilities (utilities, disability access, vehicular access and parking, fire life-safety equipment, etc.) must be in place.
 - 2. Acceptability of each unit and facility for which a Permission to Occupy is requested must be established:
 - a. Property must be inspected and Form HUD-92485 signed by the mortgagor, supervisory Architect, contractor, and HUD Representative.
 - b. Minor items that do not preclude occupancy are permitted but must be listed as an attachment to Form HUD-92485.
 - c. The contractor is fully responsible for any incomplete or improperly performed contract work whether or not listed.
- B. Signatures. Form HUD-92485 is signed by the mortgagor, supervisory Architect, contractor, and HUD representative.
- C. Submission Documents. The Lender must sign Form HUD-92485 agreeing with the request and stating that insurance risks have been covered for the project. The mortgagor must include the following documents with the completed Form HUD-92485:
 - 1. A Certificate of Occupancy or equivalent permit from the governing municipal authority for all units and facilities listed on the Permission to Occupy; and any other required permits or authorizations;
 - 2. A certificate of property insurance from the mortgagor's insurance company.
- D. Partial Occupancy Approval.
 - 1. Favorably consider partial occupancy of units as they become available, where vandalism could be minimized, needed project income is provided, an earlier rent-up date could be achieved, utility costs for occupied units can be metered separately from contractor's utilities, etc.
 - 2. Approve a series of Permissions to Occupy as units or facilities become available, e.g. individual buildings on multi-building projects, or individual floors or wings on larger buildings.
 - 3. Approve a single Permission to Occupy for all units where dictated by management considerations, e.g. very small projects.

13.15**Escrowed Funds, Letters of Credit, Deposits, Holdbacks and Related Matters****A. Mortgagor's Application for Escrowed Funds.**

Form HUD-92464, Request for Approval of Advance of Escrow Funds, must be used where the escrow is to ensure completion of offsite improvements, additive change orders, noncritical repairs (under the Section 223(f) program), or mortgagor's unpaid construction items at final endorsement.

1. The mortgagor initiates and forwards Form HUD-92464 to the Lender for its review.
2. Require the HUD inspector to reflect the percentage of acceptably completed escrow work on the HUD Representative's Trip Report, Form HUD-5379, and forward a copy after review to the Lender for use in reviewing Form HUD-92464.
3. Do not authorize advances in excess of the documented percentage completed, less previous payments and a 10 percent retainage.
4. Where excess mortgage proceeds are used to fund an escrow for completion of offsite improvements, additive change orders, or mortgagor's unpaid construction items, return the original copy of Form HUD-92464 to the depositor, and retain one copy.

B. Release of letters of credit. In the event of a claim:

1. Assignment. HUD will not accept an assignment of the letter of credit to HUD from the Lender.
2. Undrawn Balance. HUD will treat any undrawn balance from a letter of credit or escrow agreement as cash held by the Lender.
3. Cash equivalent. The Lender is required to provide cash equal to the undrawn balance, if demand on a letter of credit is not met.

C. Working Capital Deposit is established with the Lender at initial closing. It may be funded by cash, letter of credit or excess mortgage proceeds, if any.

1. Purpose. The deposit is used to:
 - a. Defray cost of initial marketing and rent-up. This includes: sales and advertising, model furnishing, and equipment and supplies essential to initial rent-up, etc.
 - b. Set up accruals for items due during the first operating year that project income is not expected to cover, including real estate taxes, permanent property insurance premiums, mortgage insurance premium, ground rents and assessments.
 - c. Cover shortfalls in interest, taxes, property insurance premiums, mortgage insurance premiums, ground rents and assessments during construction after funds available under the Building Loan Agreement are exhausted.
 - d. May be allocated to the reserves for replacement for a project with low income housing tax credits, where acceptable to the mortgagor and HUD.

2. Control and Release Of Escrow. The Lender controls disbursements from the escrow, except where the mortgagor certifies at firm commitment that any balance of the escrow will be applied to the reserve for replacements on a Low Income Housing Tax Credit (LIHTC) project. In reviewing a mortgagor's request for release of part of the escrow, consider the following:
 - a. Mortgagor's request for the release of such escrow funds must be by letter to the Lender, rather than on Form HUD-92403.
 - b. None of the escrow can be used to defray any of the hard costs of construction applicable to the Total for All Improvements, Section G of Form HUD-92264, Rental Housing Project Income Analysis and Appraisal (or other Firm Stage underwriting form applicable to the Section of Act the project is to be insured under).
 - c. Avoid premature disbursements and unnecessary expenditures.
 - d. As portions of a project are ready for occupancy, a partial disbursement may be permitted for reasonable opening expenses: however, it must be determined that the escrow is not exhausted before the entire project is complete.
 - e. An unsolicited recommendation may be offered by the Field Office that the deposit be used to cover any shortfall in interest, taxes, property insurance mortgage insurance premiums, ground rent and assessments.
 - f. Fully document all expenditures from the escrow.
 3. Final Release of Escrow.
 - a. The Lender may release any balance of the working capital escrow to the mortgagor one year after substantial completion where the project is not in default.
 - b. The Lender is advised to hold this escrow until any financial problems are resolved (e.g., has not reached sustaining occupancy, has poor liquidity or high payables, is operating at a deficit or is near default).
 - c. If the project mortgage is in default, the Lender should use any balance of the working capital escrow to cure a default, where a default occurs before its release.
- D. Release of contractor's 10 percent holdback. The holdback provides an incentive for the general contractor and mortgagor to: promptly complete the project, submit cost certification and reach final closing.
1. Amount of holdback. The Building Loan Agreement requires the Lender to retain at least 10 percent of the construction proceeds from each advance. The construction contract also provides for 10 percent holdback from the contractor's monthly payments for acceptably completed work, acceptably stored materials, and where applicable, components acceptably stored offsite.
 2. Identity of interest contractor. Except as provided in paragraphs 4. and 5. below, do not release any part of the holdback until final closing for a contractor with an identity of interest.

3. Nonidentity of interest contractor. Release the contractor's holdback or remaining balance at the next to last advance, where requisitioned on Form HUD 92403, Application for Insurance of Advance of Mortgage Proceeds, and subject to compliance with the following:
 - a. Contractor's cost certification, where required, has been reviewed and necessary adjustments made to Form HUD-92451, Financial Record and Mortgage Loan Transaction;
 - b. Contractor has disclosed its final obligations on Form HUD-92023, Request for Final Endorsement of the Credit Instrument;
 - c. All work under the construction contract has been inspected and approved by the controlling jurisdictions and/or authorities;
 - d. Certificates of occupancy or other required approvals for the dwelling units, and non-dwelling facilities, where applicable, have been issued by governmental authorities having jurisdiction. Separate buildings for community rooms, rental offices, laundry rooms, etc., commonly require certificates of occupancy;
 - e. Permission To Occupy, Form FHA-2485 has been issued by HUD for all units;
 - f. All Davis-Bacon payroll requirements have been satisfied;
 - g. Surveyor's Certificate, Form HUD-92457, and survey showing the location of all improvements, utility easements and site utility distribution lines have been submitted to HUD, and
 - h. Retain, where applicable, an adequate amount for the following:
 - (1) Items of delayed completion in an amount equal to 150 percent of the HUD representative's cost estimate for completion,
 - (2) Any owed or contested amounts indicated by mechanics, subcontractor, supplier, or equipment lessor liens, etc.,
 - (3) Lesser of the liquidated damages or actual damages computed at cost certification, and
 - (4) Net effect of negative change orders.
4. Early partial release of holdback.
 - a. After 90 percent contract completion, the Hub Director may release part of the contractor's holdback and suspend further withholding of holdback from payments due, where:
 - (1) The contractor has no identity of interest or the contractor's only identity of interest is a project ownership of less than 5 percent;
 - (2) The contractor, mortgagor and mortgagee request the early release of the holdback and attach the request to Form HUD 92403, Application for Insurance of Advance of Mortgage Proceeds; and
 - (3) Prior written consent from surety, if any, for the early release of holdback is provided with the request.

- b. The Hub Director determines that:
 - (1) The contractor's general performance warrants partial release of the holdback without conditions, or
 - (2) Partial release of the holdback with conditions, e.g., measures to assure immediate distributions to subcontractors or others, would be in the mutual interest of all participants, and
 - c. The undisbursed holdback must equal or exceed 5 percent of the contract amount.
5. Projects in difficulty. Release of part of the contractor's holdback before 90 percent contract completion may be granted only to prevent a default of the construction loan and only if it would solve the project's problems and enable it to reach construction completion.
- a. Consider the contractor's performance including:
 - (1) The completed work must be satisfactory,
 - (2) The percentage of completed contract work must be sufficient to ensure project completion within the specified contract time, and
 - (3) Do not release any holdback if there are serious, unresolved questions concerning:
 - (a) Quality of work,
 - (b) Compliance with the contract, including outstanding change orders, or
 - (c) Work is progressing behind the contractor's construction schedule, as amended by approved change orders.
 - b. Require a written consent for the early release of holdback from the surety, if any, the mortgagor, and mortgagee.

13.16**Insurance on Completion**

- A. Basic requirements during construction stage are generally the same as for projects with insured advances. However, because HUD does not insure advances for the construction loan, HUD does not monitor the Lender's disbursements. Additionally, because HUD has no risk exposure until final closing, HUD does not become involved in the workout of construction problems. The following are major variations for insurance upon completion projects.
- B. Firm Commitment to Insure upon Completion, Forms FHA-2453, FHA-2453-MM (for Section 223(f)), and HUD-92453-NH (for Section 232), must be valid and outstanding until project closing, i.e. endorsement of the permanent mortgage.
 - 1. No initial closing. Construction stage starts with the issuance of the Firm Commitment.
 - 2. Construction/rehabilitation must start within the period provided by the Firm Commitment.

3. Extensions. See Chapter 11 for the extension of:
 - a. Construction period;
 - b. Firm Commitment expiration date, where required to permit project completion and final closing.

C. Required documents include:

1. Construction contract, Form HUD-92442 or HUD-92442-A. The following must be made a part of the contract:
 - a. General Conditions, AIA Document A201;
 - b. Supplementary General Conditions, Form HUD-2554;
 - c. Davis-Bacon Wage Rates (supplied by HUD Labor Relations);
 - d. HUD Amendment to the Construction Contract to Identify Identities of Interest Between Owner/Contractor/Subcontractor/Architect;
 - e. Cost certification criteria from Form HUD-92442-A, Article 10, where an identity of interest exists, or a “cost plus” form of contract is used.
2. A complete master set of drawings and specifications and two duplicate sets;
3. The Agreement and Certification, Form HUD-3306, executed by the mortgagor, Lender, and HUD.
4. A title policy or title evidence showing:
 - a. Insured property free of all encumbrances other than the mortgage and acceptable reservations of title;
 - b. Proof that no unpaid obligations exist except as previously approved by HUD;
 - c. Title policy continued to date of credit instrument endorsement.
5. Survey and Surveyer’s Certificate, Form HUD-92457;
6. Contractor’s Requisition Project Mortgages, Form HUD-92448. The Contractor’s Prevailing Wage Certificate must be submitted at the time the mortgage is presented to HUD for insurance.
7. Assurance of funds to meet operating deficit. Completed Forms to assure funds are available to carry the project to a sustaining occupancy after final closing:
 - a. FHA-2476, Agreement of Sponsors to Furnish Additional Funds,
 - b. FHA-2476-A, Escrow Agreement, and
 - c. FHA-2477, Bond Guaranteeing Sponsor’s Performance.
8. Assurance of completion: Not applicable to insurance upon completion projects.
9. Warranty against latent defects is required in accordance with Paragraph 13.16.S below.

- D. The pre-construction conference must precede the initial start of construction. See Paragraph 13.2.
- E. Construction monitoring and reporting must be done in accordance with Paragraph 13.3.
- F. Labor and FHEO liaison. See Paragraph 13.12.
- G. Contractor's monthly requisitions are not applicable to projects insured upon completion.
- H. Offsite construction:
 - 1. Monitoring is recorded by the HUD inspector on Form HUD-5379.
 - 2. Advance of funds monitoring is not applicable to projects insured upon completion.
- I. Construction contract changes and Architect's supplemental instructions. See Sections 13.8 to 13.11 and 13.4.D. Construction changes are processed in the same manner as insurance of advances, except as modified below:
 - 1. An escrow is not required for additive change orders, because HUD has no risk exposure until final closing. The mortgagor must be able to provide the additional funds required and must not have any outstanding obligation in connection with construction other than the insured mortgage at the time the mortgage is presented for insurance.
 - 2. Surety approval is not required for the approval of additive change orders regardless of the percentage of contract increase.
- J. Permission to Occupy applies as in Paragraph 13.14.
- K. Final HUD representative's Trip Report falls under HUD procedures.
- L. Guarantee period falls under HUD procedures.
- M. Working capital deposit is not required for insurance upon completion projects.
- N. Property insurance schedule and requirements. When onsite construction is 80 percent complete (before endorsement of the credit instrument), the Lender must prepare:
 - 1. Property Insurance Schedule, Form HUD-92329, that:
 - a. Correctly shows the insurable value of the completed structures;
 - b. Reflects any changes in cost occurring after issuance of firm commitment.
 - 2. Property Insurance Requirements, Form HUD-92447.
- O. MIP is not charged until the project reaches final closing.
- P. Cost certification. See Chapter 14.

- Q. Closing must occur within the period provided in the commitment.
- R. Extension of Firm Commitment instructions are in Chapter 11.
- S. Builder's warranty. The general contractor must provide one of the following at final closing to assure correction of any latent defects:
 - 1. Cash escrow deposit of 2½ percent of the principal amount of the mortgage, to be retained in escrow by the Lender for a period of 15 months, or
 - 2. Surety bond in the amount of 10 percent of the cost of construction or substantial rehabilitation. The bond must run for 2 years after substantial project completion. The bond must be on Form HUD-3259, Surety Bond Against Defects Due to Defective Materials and/or Workmanship.

13.17**Completion of Repairs Pursuant to Section 223(f)**

- A. Required Repairs are documented by the Lender. (See Paragraph 5.26 and Appendix 5M). A list is prepared which categorizes repairs into critical repairs and non-critical repairs.
 - 1. Critical repairs must be completed before closing. Critical repairs are any individual or combination of repairs required to correct conditions that:
 - a. Endanger the safety or well-being of residents, patients, visitors or passers-by;
 - b. Endanger the physical security of the property;
 - c. Adversely affect project or unit(s) ingress or egress;
 - d. Prevent the project from reaching sustaining occupancy.
 - 2. Non-critical Repairs consist of all repairs other than Critical Repairs. Non-critical Repairs may, at the request of the mortgagor, be completed after closing.
 - 3. Completion of repairs.
 - a. Completion of repairs before closing. Require a site visit(s) and report(s) by a HUD representative to confirm satisfactory completion of required repairs before going to closing.
 - b. Completion of repairs after closing. Only non-critical repairs may be completed after closing. The following schedules are required:
 - (1) Schedule of Values for payment of completed repairs;
 - (2) Progress Schedule. All repairs must be completed within 12 months of loan closing;
 - (3) Schedule of Delayed or Interrupted Occupancy or Income, must list:
 - (a) All facilities for which occupancy or income will be delayed or interrupted by repairs delayed until after closing;
 - (b) Period of delayed or interrupted occupancy or income;

(c) Projected completion date for each facility having delayed or interrupted occupancy or income.

4. Payment for Repairs.

a. Repairs completed before closing: No mortgage proceeds may be advanced.

b. Repairs completed after closing:

(1) A repair escrow account must be established. See Paragraph 8.9.

(2) The Schedule of Values for completed repairs will be provided to the HUD inspector, who will recommend progress payments from this Schedule as a part of the Trip Report, Form HUD-5379.

B. Inspection of completed repairs is performed by the HUD inspector.

1. Inspection Reports are filed on Form HUD-5379, HUD Representative's Trip Report, for each monitoring visit. The following are included in the Trip Report:

a. Non-compliance with provisions of the commitment or closing, e.g. work write-up, drawings, specifications, etc., including changes made to the work without prior approval;

b. Adverse conditions, e.g. slow work completion, destruction of work, new municipal requirements, disputes, etc.;

c. Availability for use of facilities listed on the schedule of delayed or interrupted occupancy.

d. Municipal authorizations. Permissions to occupy, use permits, etc. Where applicable, these must be issued before closing, unless related to work delayed until after closing;

e. Items of delayed completion. The HUD inspector must include:

(1) A detailed list of any exterior work;

(2) Recommended escrow amount;

(3) Recommended completion date (not later than 12 months after closing);

2. Assignment documents. The HUD inspector should assemble the following documents to monitor repairs and recommend payments:

a. Firm Commitment;

b. Escrow agreement (where closing has occurred);

c. Survey, surveyor's report and legal description;

d. List of required repairs (work write-up);

e. Drawings and specifications (where required);

f. Schedule of Values (Required only for projects with repairs delayed after closing);

g. Progress schedule (Required only for projects with repairs delayed after closing);

- h. Schedule of delayed or interrupted occupancy or income (Required only for projects with repairs delayed after closing);
 - i. Agreement and Certification.
- C. Repair completion. All work must be acceptably completed before the loan closing, except for the following:
 - 1. Minor exterior work, which cannot be completed because of weather conditions, may be completed after closing, on projects for which prior provisions were not made for completion of non-critical work after closing. Include amount(s) to be escrowed.
 - 2. Non-critical repairs may be completed after closing when the commitment provides for it and a completion escrow is established at closing, except that:
 - a. All critical repairs must be completed before closing, and
 - b. An additional deposit must be made to the operating deficit account for all facilities for which delayed repairs will delay or interrupt occupancy or income for any period.
 - 3. Repair monitoring. All work must be monitored and accepted whether it is performed before or after closing.
- D. Final report must be made upon completion of all work. The final report must show that:
 - 1. All work is acceptably completed in accordance with the firm commitment and/or closing escrow, as applicable, and approved changes;
 - 2. Offsite work is completed or that the municipality has given written assurance for its completion;
 - 3. Utilities are connected;
 - 4. Permanent ingress and egress facilities are provided, and
 - 5. Applicable municipal inspections, approvals, etc., have been issued.
- E. Changes in the work, including associated cost changes, must be submitted by letter or other acceptable format. Form HUD-92437 may be used as a general guide, but the actual form must not be used.
 - 1. Mortgagor, HUD and Lender must sign all changes;
 - 2. Contractor and mortgagor's Architect, if employed, must sign all changes.

13.18**Construction Variations Pursuant to Section 232**

- A. General.
 - 1. For new construction and substantial rehabilitation, follow instructions for Section 221d and 220, with additions and modifications as indicated below.
 - 2. For Section 232 projects pursuant to Section 223(f), follow instructions for Section 223(f), with additions and modifications as indicated below.

B. Major Movable Equipment.

1. The mortgagor prepares Form HUD-92403, Application for Insurance of Advance of mortgage proceeds. Mortgagor:
 - a. Submits the form monthly to the Lender;
 - b. Lists all Major Movable Equipment purchased and installed within the past month on the form;
 - c. Includes all invoices for equipment purchased.
2. The Lender forwards the Mortgagor's Form HUD-92403 package, along with a copy of the Schedule of Major Movable Equipment, to the HUD inspector at the job site.

C. Inspection of Major Movable Equipment.

The HUD inspector:

1. Confirms delivery and installation of Major Movable Equipment and the invoice amounts;
2. Will only approve payment for equipment actually delivered and installed, and may change the listed equipment and requested amount on Form HUD-92403 accordingly, to agree with actual delivery and installation;
3. Initials Form HUD-92403 and returns the Form to the Lender for release of mortgage proceeds.